TED: Anti-Avoidance: Past & Future, Here & Beyond

A look at developments and tax implications across time and countries

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Tax planning is good; tax evasion is bad. Somewhere in between is a grey area – tax avoidance.

The Organisation for Economic Co-operation and Development (OECD) defines tax avoidance as “the arrangement of a taxpayer’s affairs that is intended to reduce his tax liability and that although the arrangement could be strictly legal, it is usually in contradiction with the intent of the law it purports to follow”. Governments have always had their eyes on anti-avoidance issues but this has come to the fore in the international arena as governments stepped up initiatives to tackle tax avoidance in recent years.

Against this backdrop, the Singapore Institute of Accredited Tax Professionals (SIATP) organised a technical session on anti-avoidance under its *Tax Excellence Decoded* (TED) series. Facilitated by Jerome van Staden, International Director, and Wong Hsin Yee, Director, Ernst & Young Solutions LLP, the session discussed the emerging trends and latest developments on anti-avoidance and forewarned participants of possible implications.

Developments on Anti-Avoidance

The OECD has put together a 15-point Base Erosion and Profit Shifting (BEPS) Action Plan and released its final package of measures in October 2015. Several of the BEPS actions deal with the issue of tax avoidance, including measures to counter harmful tax practices, prevent treaty abuse and prevent the artificial avoidance of permanent establishment (PE) status, to name a few. Since the release of the final package, numerous countries have started to implement the various BEPS measures, albeit with varying timing, methods and degrees of implementation.

European Union

Not long after the OECD released its final package of BEPS measures, the European Commission (EC) released its own Anti-Tax Avoidance (ATA) Package which aims to curb aggressive tax planning within the European Union (EU) in January 2016.

Included in the ATA Package was the draft EU ATA Directive, proposed amendments to the EU Administrative Cooperation Directive, recommendations to reinforce tax treaties and a communication on an external strategy for effective taxation.

Unlike the OECD’s BEPS Action Plan which is largely guidance for (and not binding on) OECD member states, the EU ATA Directive, which was unanimously approved on 21 June 2016 by the EU’s ministers of Finance and Economic Affairs, will automatically be legally binding for EU members.

Out of the five areas outlined in the EU ATA Directive, three are also covered in the BEPS Action Plan – specifically hybrid mismatches, interest deductibility limitation and Controlled Foreign Corporation (CFC) rules.

The two additional areas are general anti-abuse rule (GAAR) and exit taxation. A switch-over clause denying tax exemptions on certain income and gains that was included in the January 2016 draft has since been removed.

It is interesting to note that while hybrid mismatches are covered by both the OECD's BEPS Action Plan and the EU ATA Directive, the latter presents a significant deviation from what is proposed in the former. Based on the OECD's recommendation, the primary response in the event of hybrid mismatch arrangements should be to deny a deduction in the source jurisdiction. In contrast, the EU ATA Directive, which governs transactions between EU member states, requires the requalification of hybrid entities and payments according to the legal characterisation of EU member states where the payment is sourced.

Ernst & Young Solutions LLP Director of International Tax Services, Ms Wong Hsin Yee, gave participants in-depth insights on the developments in anti-avoidance.

While many EU countries may already have domestic anti-avoidance rules in place, the EU ATA Directive on GAAR seeks to address any gaps that may exist in the domestic rules of the respective EU members. Under this Directive, arrangements that are not supported by valid commercial reasons reflecting economic reality may be caught. Essentially, the Directive stipulates that non-genuine arrangements be ignored when calculating the corporate tax liability. Instead, tax liability should be calculated by reference to the economic substance in accordance with the national law.

ASIA-PACIFIC

Closer to home, many countries in the Asia-Pacific are implementing (or at least considering to implement) the various BEPS recommendations on anti-avoidance put forth by the OECD. While the use of GAAR has not been prevalent in the region, specific anti-avoidance rules have been more widely applied. It has been observed that PE and transfer pricing issues have been an area of focus of regional tax authorities. There is also a growing trend to adopt a "substance over form" approach in the Asia-Pacific.

When navigating through the Asia-Pacific, it is perhaps important for companies to appreciate the vast difference in the level of implementation of anti-avoidance and BEPS measures between pacesetters (such as Australia and China) where there is a focus on anti-avoidance and legislations which are being reviewed and amended, and late adopters (such as Thailand and Vietnam) where there has been little or no action observed to date.

SINGAPORE

Singapore, while not among the pacesetters in the region, is an active participant in the global discussion on BEPS. By joining the inclusive framework for the global implementation of the BEPS Project and becoming a BEPS Associate as announced by the Ministry of Finance on June 16 this year, the country signalled its support for the key principles underlying the BEPS Project, namely that profits should be taxed where the real economic activities generating the profits are performed and where value is created.

In line with the global focus on anti-avoidance, the Inland Revenue Authority of Singapore (IRAS) has set up a tax shelter team to identify and deal with abusive tax shelter schemes. The IRAS has also published an e-tax guide on 11 July 2016 outlining the general anti-avoidance provision and its application. This demonstrates the seriousness adopted by IRAS in tackling this issue.

Impact on Structuring

Bearing in mind the emerging trends and latest developments on anti-avoidance, corporate groups should consider the following possible impact on their legal structures:

HYBRID MISMATCHES

Corporate groups with existing intragroup financing arrangements should review their arrangements to ensure they do not fall within the definition of hybrid mismatch rules.

CFC RULES

The introduction and/or refinement of CFC rules around the world will impact how corporate groups invest into Asia-Pacific. The implementation of CFC rules may mean that incomes are required to be taxed in the parent company's jurisdiction notwithstanding that they have not been repatriated. This could potentially drive up the group's overall effective tax rate. As such, it is crucial for companies to stay keenly aware of legislative changes on CFC rules in the countries where they operate, so as to assess the tax impact arising thereof.

LIMITATION OF INTEREST DEDUCTION

As countries consider the OECD's recommendation to limit net interest deduction within a range of 10% to 30% of earnings before interest, taxes, depreciation and amortisation (EBITDA), corporate groups with a centralised financing company should assess whether it would still be sensible to do so in the future. From a corporate group's point of view, interest expenses incurred in excess of the interest deduction limit would effectively be "lost" as they have no deduction value.

ANTI-TREATY ABUSE

Proposed anti-treaty abuse rules may mean that companies, especially passive investment holding companies, would be increasingly scrutinised by tax authorities on their substance when applying for certificates of residence (COR) to support their use of double tax treaties. This highlights the heightened need for corporate groups to review their corporate structures to ensure robust commercial substance in their legal entities. In addition, corporate groups should also consider the impact of anti-treaty abuse rules on their income flows when they repatriate income back to their home countries.

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PERMANENT ESTABLISHMENT

In response to the OECD's recommendation to lower the threshold for PE, corporate groups, especially those whose fact pattern falls within the scenarios illustrated in BEPS Action 7 such as commissionaire arrangements and marketing support offices, should review and ascertain whether their activities would now constitute a PE under the lowered threshold. Corporate groups should look into the need to restructure their operating model in this regard.

Impact on Tax Compliance and Processes

Besides the impact on structuring, the latest developments on anti-avoidance also impact tax compliance and processes.

As the world moves towards higher tax transparency and enhanced tax reporting, tax authorities are raising tax compliance requirements and stepping up their scrutiny on taxpayers with regard to substance, treaty benefits, incentives and more. In response, companies must ensure that information is available when requested to substantiate their positions. It is therefore timely for companies to review and ensure that their current business processes and information technology (IT) systems are robust enough to capture the required information to produce comprehensive documentation in support and defence of their tax positions.

In this era of tax uncertainties, companies need to understand the tax landscape, evaluate the potential impact of the emerging trends and tax developments on their respective organisations, develop a suitable approach and confidently execute the plan. Most importantly, companies must continue to monitor the changing tax landscape and be ready to modify their approaches.

Stay nimble; be in the know.

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